

Chapter 4

Taxes

Understanding the taxes that apply to your business and how to meet the legal requirements of those taxes is critical. Consultation with an accountant or attorney is advisable.

The legal structure you select for your business will determine how business income is taxed – as individual income (e.g., sole proprietorship) or as a corporation.

If a business operates as a sole proprietorship, partnership or Limited Liability Company (elected to be taxed as a sole proprietorship), all business income is attributed directly to the owner(s) who are taxed accordingly. People in this category take payment as a an owner's draw and pay self-employment taxes.

If the business is taxed as a corporation, the income to the business is taxed and then any payment to officers or shareholders is taxable income.

Self-employment taxes and corporate income taxes should be estimated, reported and paid on a quarterly basis. Taxes are then reconciled at the end of the fiscal (tax) year for the business.

FEDERAL TAXES

FICA

The Federal Insurance Contributions Act provides for a federal system of old age, survivors, disability and hospital insurance (Medicare). The old age, survivors and disability portion is financed by the Social Security Tax, while the hospital insurance portion is financed by the Medicare tax.

Self-Employment Tax

You must pay Self-Employment Tax if:

- You were self-employed and your net earnings from self-employment (excluding any church employee income) were \$400 or more; or
- You performed services for a church as an employee and received income of \$108.28 or more. However, if you are a member of the clergy or a religious worker, you may not have to pay Self-Employment Tax.
- You are self-employed if you carry on a trade or business as a sole proprietor, an independent contractor, a member of a partnership, LLC, or are otherwise in business for yourself.
- You do not have to carry on regular full-time business activities to be self-employed. Part-time work, including work you do on the side in addition to your regular job, may also be self-employment.

A trade or business is generally an activity carried on for a livelihood or in good faith to make a profit. The facts and circumstances of each case determine whether or not an activity is a trade or business. Regularity of activities and transactions and the production of income are important elements. You do not need to actually make a profit to be in a trade or business as long as you have a profit motive. You do need, however, to make ongoing efforts to further the interests of your business.

The Self-Employment Tax rules apply even if you are fully insured under social security or have started receiving benefits. For more information obtain a copy of Publication 533 Self-Employment Tax by calling the IRS at 1-800-829-3676 or download from the web at <http://www.irs.gov/pub/irs-pdf/p533.pdf>

Corporate Estimating Tax

A corporation must file with the state a Declaration of Estimated Tax (MO Dept. of Revenue form MO-1120ES) and a Federal Estimated Tax (IRS form #1040ES).

Excise Tax

The federal Government imposes excise taxes on various types of business activities. Some excise taxes are on the production or sale of certain goods, while others are on services or the use of certain products or facilities. Still others are imposed on specific types of businesses.

Federal excise taxes can be broken down into several major categories.

- Motor vehicle highway use tax;
- Retailer taxes on certain fuels;

Retail excise taxes are imposed on sales of:

- Heavy trucks and trailers;
- Tires and tubes;
- Recreation equipment, such as bows, arrows, fishing rods, reels, lures, and creels;
- Firearm and ammunition.

In addition, excise taxes exist on following as well:

- Air transportation - If you are in the business of transporting people by air, you may have to collect an excise tax;
- Telephone and teletype services;
- Wagering;
- Coal mined in the United States;
- Alcohol and tobacco products;
- Manufacturers of certain vaccines - Certain vaccines manufactured or imported into the United States are subject to an excise tax in order to create a Vaccine Injury Compensation Trust Fund, a no-fault program for compensating persons who are injured by, or die from, certain vaccines.
- An excise tax on ozone-depleting chemicals;
- An oil spill liability excise tax
- Environmental taxes on petroleum products, various chemicals, and hazardous wastes.

A luxury tax applies to retail purchases of passenger automobiles costing more than \$30,000.



For further information on excise taxes, refer to IRS Publication 510, Excise Taxes.
For more detailed information on other federal taxes, refer to IRS Publication 334,
Tax Guide for Small Businesses. <http://www.irs.gov/pub/irs-pdf/p510.pdf>

STATE TAXES

Missouri's tax structure provides corporations with one of the most favorable situations in the nation. Our tax requirements are responsibly based and competitive. Yet, because Missouri government is efficiently managed-deficit spending is unconstitutional--it can still maintain a high level of services and facilities through its sound fiscal practices.

Corporate Income Tax

In most cases, a company located in Missouri will have a lower corporate tax bill than in other states. State law sets the corporate income tax rate at a percentage of net taxable income earned by a business in Missouri. In addition, Missouri allows a portion of federal income tax payments to be deducted before computing taxable income.

Missouri Taxable Income

An important tax advantage for Missouri businesses is the amount of income considered taxable - only income earned in Missouri is taxed. Two allocation options are offered for calculating this income: (1) the three-factor formula, based on sales, property and payroll, or (2) the single-factor formula, based only on sales. Missouri is the only state that permits companies to choose the formula that results in the lesser corporate income tax liability. This means that companies are not penalized for locating property and jobs in Missouri as they are in the other states. In addition, it is important to note that Missouri has not adopted worldwide or nationwide unitary tax assessment in computing multinational corporate income tax liability.

THREE-FACTOR FORMULA

A single state operation determines its intrastate sales and sales to non-nexus states to find the proportion of total or gross sales. A multi-state company computes these same two types of sales, and in addition, sales originating in another state and terminating in Missouri, to determine Missouri's proportion of gross sales. Using this percentage of sales and percentages of property and payroll in Missouri, an average results in a ratio that is applied to taxable income.

Single-Factor Formula

The single-factor formula is based only on sales. Fifty percent of interstate sales and 100% of Missouri intrastate sales are combined. This total is then divided by gross sales to determine the apportionment percentage.

Sole Proprietorship/Partnership/S Corporation

All net business income is taxable to the sole proprietorship or to the partnership/S Corporation according to each partner or shareholder's share of ownership. Your personal income tax rate depends on your level of total personal income. On your federal return you may be able to deduct from your gross income some personal expenses that are directly related to your business.

Property Tax

Property tax is often a major tax expense for a company. Yet because it is set and administered locally, property tax is seldom comparable from state to state. Not only do tax levies vary widely

from one city to another, but the assessment ratio for determining property value differs significantly among the 50 states. Even within one state, assuring a uniform assessment practice is very difficult.

Missouri law sets the assessment ratio for personal property at one-third of true value throughout the state. Real properties (land and buildings) classified as commercial and industrial, are assessed at 32%; residential, 19%; and agricultural, 12% of true or fair market value. The local property tax rate is an aggregate of school, city, county, and state levies expressed in tax per \$100 assessed valuation. Commercial and industrial real property is assessed an additional county surcharge designed to replace revenues lost by the tax exemption of business inventories.

Inventories Exempt

Manufacturer's inventories (raw materials, goods in process and finished goods), as well as goods and wares of retailers, distributors and wholesalers are exempt from property taxes in Missouri.

Real Property Abatement:

Urban Redevelopment Corporations Law ("Chapter 353") and Missouri Enterprise Zone Law

Missouri promotes urban redevelopment through a potential 25-year ad valorem tax incentive program known as Chapter 353. Under this program, up to 100% of improvements to real property may be exempt from state and local property taxes for up to 25 years. This law is applicable to any size city in Missouri.

Missouri enterprise zones may also abate improvements to real property up to 100% for up to 25 years.

Withholding Tax

Every employer maintaining an office or transacting any business in Missouri and making payment of wages to a resident or nonresident individual must obtain a Missouri Employer Tax Identification Number. State tax is then withheld from the employees payroll and remitted to the Missouri Department of Revenue. For more information contact: Tax Administration Bureau, P.O. Box 999, Jefferson City, MO 65108-0999; phone: 573/751-5752.

Refer to Chapter 5, "Hiring Employees," for a detailed discussion on hiring employees.

Unemployment Insurance

Most companies doing business in Missouri are required to pay unemployment insurance to protect their workers during unemployment. This applies to most businesses having one or more workers on the payroll for 20 weeks during the calendar year, and to businesses paying an individual employee \$1,500 in a given quarter.

SHARED WORK PROGRAM

In 1987, Missouri initiated the Shared Work Program to encourage job retention. Under the program, employers reduce work hours a certain percentage, rather than lay off employees. Those employees then receive both wages for actual hours worked, and partial unemployment insurance benefits. For example, if work hours are cut by 20%, the employee would receive 20% less in wages, but would also receive 20% of his weekly unemployment benefits. The benefits paid are then charged to the employer's unemployment insurance account and affect his tax rate for four years.



For more information regarding tax liability and/or unemployment insurance benefits, contact the Division of Employment Security, P.O. Box 59, Jefferson City, MO 65104-0059; phone (573) 751-3215; or visit their website at: www.dolir.state.mo.us/es/dolir4b.htm

Worker's Compensation

In every state, business and industry incur some expense to provide their employees with worker's compensation coverage. In Missouri, all businesses with five or more employees (except agricultural or domestic labor) must provide worker's compensation insurance to protect their workers in case of job-related injury, illness, or death. Companies can offer this protection through a private insurance carrier or they can become self-insurers. Premium rates vary, depending on the risks associated with special occupations. As in most states, the premium rates apply to an employee's total annual salary.

A complete discussion of Worker's Compensation can be found in Chapter 5, "Hiring Employees."

Franchise Tax

Missouri's franchise tax is based on capital employed in a company. Corporations with less than \$1,000,000 outstanding shares and surplus are not taxed. Multi-state corporations are subject to franchise tax only on that portion of total company shares and surplus that occurs in Missouri. The tax is computed by applying the percentage of total property and assets, which occurs in Missouri to total company shares and surplus.

Personal Income Tax

Missouri's individual income tax rates are graduated from a low of 1½% on taxable incomes of \$1,000 or less, to a high of \$315 plus 6% on taxable incomes in excess of \$9,000. Taxable income may be reduced by a portion of federal income tax liability. Additional deductions include an allowance for each dependent, personal exemption, and federal standard or itemized deductions (which includes a deduction for FICA taxes paid through withholding).

Sales Tax Number

Any business making retail sales must obtain a Missouri Retail Sales License from the Missouri Department of Revenue. A bond, based on projected monthly gross sales, must be posted at the time of application. An application form (Form #2643) to register for sales tax can be obtained from the Missouri Department of Revenue or from our office. Generally, a wholesaler or manufacturer will present a Sales/Use Tax Exemption Certificate (Form #149) to the seller showing the sale is exempt from sales tax.



Forms required: MO Revenue Form 2643; MO Revenue Form 149
www.dor.state.mo.us/tax/business/sales/forms/01_149.pdf

The Missouri Department of Revenue also maintains a "Forms by Fax" service that permits you to obtain, by fax, many tax forms you will require (both state and some federal forms). To use this service, simply dial 573/751-4800 from your fax machine's handset and follow the instructions to request the forms you need. The forms will be faxed immediately to your fax

machine. For the four-page Master Document List, showing the form request numbers for all forms, request Document No. 1.



The Department of Revenue also has a homepage on the World Wide Web. Individuals with access to the Internet can obtain informational materials and Missouri tax forms via this source. The address is: <http://www.dor.state.mo.us>

For assistance with particular tax matters, please contact your nearest Missouri Department of Revenue Taxpayer Service Center. A complete listing is found in the Resources section of this publication.

RETAIL SALES TAX

Any person or company that has a business location in Missouri from which they sell or lease goods to a final consumer is required to collect and remit Missouri sales tax. Also, any company that leases motor vehicles (including boats, trailers, and outboard motors) is required to collect and remit Missouri sales tax. If the lease period is 60 days or less, the sales tax is based on the address of the lessor. If the lease period is over 60 days, the sales tax is based on the address of the lessee. It is the business' responsibility to ensure that sales tax is collected at the correct tax rate. You must have a Missouri Retail Sales License prior to making sales. If you conduct retail sales without a valid Missouri Retail Sales License, you may be assessed a penalty in the amount of up to \$500 for the first day and \$100 for each subsequent day, not to exceed \$10,000, in addition to any other penalties or interest that may be imposed. For the first twenty days this penalty does not apply to persons opening a business in the state of Missouri for the first time.

A bond must accompany the application for the license. The amount of the bond is based on your estimated monthly gross sales. The amount of your bond is calculated as follows:

$$\begin{aligned}\text{estimated monthly gross sales} \times \text{your tax rate} &= \text{monthly tax} \\ \text{monthly tax (round to highest \$10)} \times 3 &= \text{amount of bond}\end{aligned}$$

"Estimated monthly gross sales" is the amount of sales you estimate your business will make in taxable sales in an average month. If you are a small business, one of the things you should consider in estimating your average monthly gross is your operating expenses, such as rent, utilities, etc. Your average monthly gross should be higher than your estimated operating expenses. If you calculate the amount of bond to be less than \$500, you are only required to submit a \$25 bond. If you calculate your bond to be \$500 or greater, you should submit the amount of bond figured.

Example 1: Ms. Brown will be opening a craft store in Jefferson City, which has a sales tax rate of 6.225%. Because the business is new and has no history of sales, she must estimate her average gross sales per month to compute the bond. Ms. Brown estimated her average gross sales to be \$5,000 per month. This is how Ms. Brown computed her bond:

$$\begin{aligned}\$5,000 \times 6.225\% &= \$311.25 \quad (\text{round to next high ten} = \$320.00) \\ \$320 \times 3 &= \$960.00 \\ \text{Amount of bond} &= \$960.00\end{aligned}$$

Example 2: Mr. Wilson is purchasing a bait shop in Columbia which has a sales tax rate of 6.975%. The previous owner of the bait shop averaged \$2,000 per month in sales. This is how Mr. Wilson computed his bond:

$\$2,000 \times 6.975\% = \139.50 (round to next highest \$10 = \$140)

$\$140 \times 3 = \420

Amount of bond = \$25 (\$420 is less than \$500, therefore a \$25 bond may be posted)

If you are unable to estimate your bond, you can contact the Tax Administration Bureau (573/751-5860) or one of the Regional Field Offices listed in the Chapter 7, "Resources", under Department of Revenue. The Tax Administration Bureau reviews all bond amounts to ensure they are sufficient and in accordance with Missouri Statutes. The following items are taken into consideration when determining a sufficient bond amount: previous ownership of business, types of products or services sold, location of business, business hours, operating expenses, etc.

Bonds may be posted in the following manner:

1. Cash Bond
2. Surety Bond
3. Irrevocable Letter of Credit
4. Certificate of Deposit

Complete information on the various types of bonds is included in the Missouri Tax Registration Application.

SALES/USE TAX

Use tax is similar to sales tax, but is imposed when tangible personal property comes into the state and is stored, used or consumed in Missouri. Communities have the option of adopting a local use tax equal to the local sales tax for that community.

Missouri has responded to the needs of industry by providing major exemptions from sales/use taxes. For a list of the current exemptions refer to the Missouri Department of Revenue's website at: <http://www.dor.state.mo.us/tax/faq/faqsales.htm>

FOOD SALES

Effective October 1, 1997 a three percent (3%) sales and use tax exemption exists for certain food items. Examples of exempt foods include: general food items; fresh fruit and vegetables; meat, eggs, dairy products; ice, water - including bottled water; cold drinks; candy, gum; coffee beans/ground coffee/instant coffee; bread; spices, cooking spray, shortening; foods (not hot) sold through vending machines. Certain vending machine sales also qualify for the 3% exemption. Contact the Missouri Department of Revenue (573/751-2836) for more information.

VENDOR'S USE TAX

Out-of-state businesses making sales of goods to the final consumer located in Missouri, may be required to collect and remit Missouri vendor's use tax. They must obtain a Missouri Use Tax License and post a bond.

Out-of-state businesses that lease goods to Missouri customers from an out-of-state business location are required to collect and remit Missouri vendor's use tax. They also must obtain a Missouri Use Tax License and post a bond.

CONSUMER'S USE TAX

If your business is located in Missouri and is purchasing goods from an out-of-state vendor for consumption, when Missouri tax was not collected at the time of purchase, you are required to

remit Missouri Consumers Use Tax. You must register for the payment of Use Tax; however, no bond is required. For more information, call 573/751-2836 or 1-800-877-6881.

FEE ON THE SALE OF NEW TIRES

Retail sellers of new tires are required to collect from the purchaser of the new tires, a fee of \$.50 for each new tire sold. The fee is then remitted to the Missouri Department of Revenue. For more information, please contact: Tax Administration Bureau, Tire Fee, P.O. Box 3040, Jefferson City MO 65105-3040; phone: 573/751-2836.

CIGARETTE AND OTHER TOBACCO PRODUCTS

Missouri law requires all wholesalers of cigarette and other tobacco products to secure a written license from the Director of Revenue. For more information on the requirements for these sales please contact: Tax Administration Bureau, Miscellaneous Tax Section, P.O. Box 811, Jefferson City, MO 65105-0811; phone: 573/751-5857.

FUEL TAX

Missouri law requires transporters, distributors and terminal operators of fuel to be licensed with the Missouri Department of Revenue. For more information, contact the Tax Administration Bureau, Fuel Tax Section, P.O. Box 300, Jefferson City, MO 65105-0300; phone 573/751-2611.

CRAFT SELLERS

Craft sellers must charge the sales tax rate at the point of sale. For example, a vendor from Kirksville that sells at a show in Springfield, must charge the sales tax rate for the city of Springfield and note those sales separately on their sales tax report to the MO Dept. of Revenue. If you go to a show in another state, you need to obtain a sales tax number for that state unless the sponsor of the show has obtained a sales tax number and is collecting and reporting for all vendors at the show.

Purchase of Existing Business

Before you purchase an existing business, be sure that you obtain a "Certificate of No Tax Due" (issued by the Missouri Department of Revenue) from the previous owner of the business. Without this document, you may also be purchasing existing sales or withholding tax obligations.

FRANCHISE TAX

Missouri's franchise tax is based on capital employed in a company. The rate is one-twentieth of one percent, or \$0.50 per \$1,000 of par value of outstanding shares and surplus or total assets. Corporations with less than \$200,000 outstanding shares and surplus are not taxed.

STATE TAX CREDITS

The State of Missouri, through the Department of Economic Development and other departments, administers numerous tax credits designed to help create new jobs and investment in Missouri. Please refer to the Economic Assistance Center (www.ded.state.mo.us/business/economicassistancecenter/) for information on the programs.

RECORDS RETENTION

New business owners frequently have questions about the records they must keep for tax purposes. The following list includes the most common documents you should keep. All

businesses should retain items 1 through 6. If you are operating a business that makes retail sales, you should also keep items 7 through 10.

1. Copies of Federal Income Tax returns (retain at least three to five years).
2. Sales journals and/or receipts journals (retain at least five years).
3. Purchase journals and/or check registers (retain at least five years).
4. General ledgers (retain at least five years).
5. Detailed depreciation schedules (retained until items are fully depreciated, or at least five years, whichever is longer). Note: The depreciation schedule should show detail as to where the item was purchased. It is also suggested that all purchase invoices listed on the depreciation schedule be filed separately rather than with the other expense purchases.
6. Copies of paid bills for goods and services (retain at least five years).
7. Copies of Letters of Exemption to support claims for exemption regarding sales to tax exempt entities. You should be aware of the expiration date on each letter of exemption.
8. Copies of the checks from tax exempt entities to prove that payment for the tangible personal property or taxable service was made from the funds of the tax exempt entity and not those of an individual member of the tax exempt entity.
9. Updated and fully completed resale exemption certificates. (Resale exemption certificates must be signed by an owner or officer and must be updated every five years.)
10. Copies of the sales and use tax returns and backup documents used to prepare these returns (these should be retained at least five years).

The following payroll records should be retained for at least three years in the event of a withholding tax audit:

1. Copies of W-2 forms
2. Monthly payroll records showing the actual Missouri withholding
3. Copies of the MO941 reports

The nature of your business may require that you keep additional records. Please use these lists as a general guide, but consult with your tax practitioner for advice about your specific needs.